



Australian Government

Council on Federal Financial Relations

Affordable Housing Working Group: Issues Paper



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Consultation

The Affordable Housing Working Group ('the Working Group') has been established by the Australian Government under the Council on Federal Financial Relations (CFFR). Its objectives are to:

- identify potential financing and structural reform models that increase the provision of affordable housing (social housing and housing in the private rental market) for those on low incomes;
- provide assessments of potentially viable proposals put forward by stakeholders; and
- outline the best method to progress further any models that are identified as potentially viable.

The Working Group is seeking submissions from interested parties on innovative ways to improve the availability of affordable housing. While the Working Group remains open to receiving feedback on affordable housing more broadly, it is particularly seeking submissions focusing on the areas highlighted by this paper.

The information obtained through this process will be used to develop viable options that may be considered by Heads of Treasuries before being presented to the CFFR.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

All information contained in submissions will be made available to the members of the Working Group (the Australian Government, the New South Wales Government, the Victorian Government and the Western Australian Government).

Unless you indicate that you would like all or part of your submission to remain in confidence, it will also be available to the public on the Commonwealth Treasury website.

Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

Closing date for submissions: **11 March 2016**

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Purpose of the Issues Paper

On 7 January 2016, the Australian Government announced that the Council on Federal Financial Relations (CFFR) would form an Affordable Housing Working Group ('the Working Group') following a request from Treasurers for further work on housing affordability at the CFFR meeting in October 2015.

The Working Group will focus primarily on improving the supply of affordable housing, through the introduction of innovative, transformative and implementable financing models. These models will focus on the social housing sector, and the private rental market, and be targeted at low-income households.

This Issues Paper seeks to provide the necessary background to allow interested parties to focus their submissions on the Working Group's key areas of interest. Refer to the section *Focus of submissions* for further guidance.

The outcomes of this process will be used to inform policy development and the potential implementation of a viable model(s) to support the improved supply of affordable housing. Viable models identified through the submission process, and subsequent further analysis, may be utilised by various levels of government, singularly or across multiple jurisdictions.

Scope of the Working Group

The Working Group is seeking proposals that improve the supply of affordable housing, and maximise the effectiveness of government expenditure. In doing so, the Working Group will focus on the twin goals of maintaining a strong social housing safety net for those on the lowest incomes and in the greatest need, while also facilitating large-scale market investment in an affordable rental market.

The Working Group will ensure that outcomes from this process are complementary to the broader work underway, through:

- CFFR's Housing Supply Working Group;
- the Cities Agenda;
- the Review of Australia's Taxation System;
- the Reform of the Federation process; and
- the various housing strategies and reforms being undertaken at the state or territory level.

The Working Group will not be seeking to undertake a detailed examination of existing policy settings including Commonwealth Rent Assistance (CRA), the National Rental Affordability Scheme (NRAS), taxation, land release, planning, zoning, or the regulation of community housing providers. Where these settings are raised as part of submissions, they will only be considered to the extent that they play a crucial role in facilitating the effective implementation and operation of a viable model to improve the availability of affordable housing.

Submissions should take into account the current constrained fiscal environment across the Commonwealth and states and territories.



Background

Importance of housing

The Working Group acknowledges that there are few issues more important to ensuring the welfare of Australians than housing. From a social perspective, housing provides a stable base from which Australians can participate in their communities. Housing assists with family formation and security in retirement, and promotes and improves employment, educational and health outcomes. From an economic perspective, housing has a significant impact upon investment, productivity and participation, as well as consumption and saving trends across the economy.

Role of government

Governments have access to a number of key policy and economic levers which can impact both the demand for, and the supply of, affordable housing. Housing trends are also shaped by cultural and behavioural elements reflected in society, some of which are shaped by government policy, and these present additional influences and barriers to improving the availability of affordable housing.

At the Commonwealth level, taxation settings, financial sector regulation, infrastructure development, immigration policy, the income support system and national housing agreements all affect housing outcomes.

At the state and territory level, taxation settings, strategic and statutory planning systems, infrastructure development and the operational settings for social housing also impact on housing supply outcomes. The role of local government is also significant in the supply of affordable housing, through its role in administering the planning and development systems.

Governments can use these levers, including funding, policy, regulatory and legislative elements to enable innovative solutions for affordable housing.

Current state of the housing market

The market is broadly made up of three main categories of households (see Figure 1):

- those who live in their own home, either with or without a mortgage;
- those who rent in the private rental market, with or without government assistance; and
- those who cannot access the private rental market.

Figure 1: Housing Continuum



Households in all of these categories may experience rental or mortgage stress, generally defined as spending more than 30 per cent of their income on housing costs.



Recent Australian Bureau of Statistics (ABS) data indicates that, in 2013-14, 67.2 per cent of all households were owner-occupiers with or without a mortgage and 31 per cent of all households were renters. Approximately 3.6 per cent of households rent in public housing.¹

The ABS reports that, of the around 3.6 million lower income households² in Australia, 26.8 per cent had housing costs that were greater than 30 per cent of their gross household income. 40.3 per cent of low income households with a mortgage had housing costs of above 30 per cent, compared with 50.1 per cent of renters. This equates to around 657,000 low-income households across Australia in rental stress and around 318,000 low-income households in mortgage stress.³

Around 187,500 households remain on waiting lists for public and community housing across Australia.⁴

What is affordable housing?

The Working Group notes that there are multiple definitions of affordable housing. For the purposes of this Issues Paper, in the context of affordable rental housing, the following definition applies:

Affordable housing is that which reduces or eliminates housing stress for low-income and disadvantaged families and individuals in order to assist them with meeting other essential basic needs on a sustainable basis, whilst balancing the need for housing to be of a minimum appropriate standard and accessible to employment and services.

Current issues with the availability of affordable housing

The focus of this Issues Paper is on the availability of affordable housing. However, as housing exists on a continuum (see Figure 1), it is important to note that the trends within other components of Australia's housing market can have flow-on effects for the availability of affordable housing.

Australia has experienced a significant appreciation in dwelling prices over the last 15 years, driven by a range of factors including high population growth, increased access to finance, sustained economic growth, increased investor activity and relatively unresponsive housing supply.

The most noticeable impacts of this significant increase in real dwelling prices has been the reduction in home ownership experienced by younger Australians, an increase in the percentage of Australians renting, and greater competition in the rental market especially for properties at the lower end of the market.

Rising house prices and higher rents have also increased the time needed to save a deposit, contributing to people remaining in the rental market for longer.

¹ ABS, 6523.0 Household Income and Wealth, Australia, 2013-14 – Table 12.3. Available at: www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6523.02013-14?OpenDocument

² To enable analysis of various tenure groups in the ABS Housing Occupancy and Costs publication, a lower income group is formed comprising the 38% of people with equivalised disposable household income between the 3rd and 40th percentile. This group is referred to as lower income households.

³ ABS 4130.0 Housing Occupancy and Costs, 2013-14 – Table 15. Available at: www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14?OpenDocument.

⁴ Productivity Commission 2016, *Report on Government Services 2016 Chapter 17*.



Private sector provision of affordable housing

Where demand for housing exceeds supply, this would generally lead to an increase in the supply of housing stock provided by the private market. However, in the context of affordable housing, this has not occurred largely for two key reasons.

The first is that restrictive planning, zoning and land release policies have the effect of limiting the available supply of development sites for new housing. As a result, developers invariably have more attractive development options for the limited number of available sites. Recent significant increases in dwelling approvals, commencements and completions has done little to increase the supply of affordable rental housing, as the majority of new housing construction has been at the less affordable end of the market.

The second is the risk return profile of affordable housing. Tenants accessing affordable housing generally have lower levels of income, or potentially fixed levels of income. This reduces the ability of property owners to increase the income streams they can generate by raising rents, increasing the risk that has to be borne by the property owner. The low income of affordable housing tenants can also reduce the attractiveness of the yield that can be generated from affordable housing assets, especially in periods of low capital growth.

The Working Group is interested in obtaining a more detailed understanding of the magnitude of the gap between the returns available through affordable housing assets, and the returns the private sector would require to increase their investment in the sector.

The current gap indicates that there is a need for new, viable and scalable financing models to deliver additional affordable housing. Several possible approaches are discussed in the next section. The Working Group is seeking feedback on the degree to which innovative models can reduce the gap in returns, and the most efficient role governments could play in addressing any remaining gap.

Social housing

As at June 2015, there were 403,767 social housing dwellings across Australia. This consists of 321,627 public housing dwellings, 72,105 community housing dwellings and 10,035 state-owned and managed Indigenous housing dwellings (SOMIH).

The sustainability of public housing presents an ongoing challenge for governments. In simple terms, the rent received from tenants does not cover operating costs, or fund new supply. Some states and territories continue to sell off stock and/or transfer management of existing stock to community housing organisations. The transfer of stock is undertaken for a range of reasons, including maximising access to CRA, but additionally for a number of reasons as stated at *The role of the community housing sector* section.

Table 1 shows the decline in public housing stock and the rapid increase in community housing stock, which is mostly indicative of stock transfers undertaken at the state and territory level.



Table 1: Social housing dwellings nationally⁵

Year (as at 30 June)	Public housing	Community housing	SOMIH	Total
2015	321,627	72,105	10,035	403,767
2013	328,340	65,865	10,084	404,289
2011	331,371	59,777	9,820	400,968
2009	336,464	42,384	12,056	390,904
2007	339,771	34,707	13,098	387,576

Note: data may not be comparable over time and comparisons could be misleading and should be considered as indicative only. Excludes dwellings owned and managed by Indigenous community housing organisations due to data unavailability for 30 June 2015.

The 2013 Audit Report of New South Wales (NSW) social housing⁶, noted that tenants are staying in social housing longer, exit rates are falling, waiting lists are growing, maintenance costs of ageing stock is increasing, and the stock itself has become poorly adapted to purpose. Tenant demographics have also changed over time, from family-based dwellings to predominantly high-need singles (including older people and people with disabilities).

There has also been a continued reduction in the revenue base of public housing as tenancies have been increasingly targeted to tenants with greatest needs and/or special needs who are reliant on Commonwealth income support payments.

In NSW, the primary source of income for 94 per cent of subsidised public housing tenants is Commonwealth income support, with only five per cent listing wages as their main source of income. Considering the households relying on Commonwealth income support, over two thirds are supported by the Age or Disability Support Pensions.

These ongoing issues mean that the provision of affordable housing is increasingly too large a problem for governments to solve and finance alone.

The role of the community housing sector

The community housing sector provides social and affordable housing and predominantly consists of not-for-profit organisations. The size and scope of the community housing sector, and its relationship to public housing authorities, varies considerably across states and territories. The growth in community housing reflects the policy direction of the states and territories, supported in part by Commonwealth housing initiatives.

Community housing can deliver some advantages as a model for providing affordable housing. Depending on the size and scope of the individual community housing provider, they can:

- offer improved access to private finance;
- offer a wider housing service, enabling tenant transition from social housing to affordable housing;
- access additional taxation benefits via being endorsed charitable organisations;

⁵ Productivity Commission 2016, *Report on Government Services 2016* Chapter 17.

⁶ New South Wales Auditor General's Report: Performance Audit, 2013 *Making the best use of public housing*



- offer improved asset management; and
- improve tenant outcomes through tailored personal support.

However, the community housing sector is not currently viewed as a mature asset class, and as such private financing institutions offer finance at unfavourable terms compared to other private sector businesses. The overall funding and policy framework of the community housing sector is largely set at the state and territory level, but the sector is heavily dependent on Commonwealth income support, including CRA, as a revenue stream. Community housing organisations continue to experience difficulties in building the balance sheets and cash flows necessary to operate at the scale required to secure finance for expansion, except by relying on the transfer of public housing dwellings.

Large growth-orientated community housing organisations may have the potential to become substantive players in the provision of large-scale affordable housing solutions. The Working Group invites proposals which discuss how the community housing sector would interact with new financing models listed in the next section.



Financing models to consider

A long-standing challenge in enabling affordable housing has been establishing a sufficiently large and continuous stream of funding; which would ideally be predictable, sustainable and responsive to demand. A potential model could use aspects of existing successful financing models found in overseas jurisdictions, and establish a means by which institutional investors can provide finance at a desirable scale.

There are many advantages to encouraging institutional investment in affordable housing. These include expanding the funding mix outside of financial institutions, diversifying the Australian rental housing market by reducing reliance on 'mum and dad investors', and the formation of strategic and at-scale affordable housing organisations.

The nature of capital markets, the specific requirements of large institutional investors and the approaches taken internationally, all highlight three essential and interrelated elements required to attract large-scale investment. These are:

1. an effective interface to the capital markets to efficiently raise wholesale funds;
2. a dedicated intermediary to manage the relationship with capital markets and aggregate, allocate and manage associated finance to housing providers; and
3. an appropriate and effective affordable housing delivery system.

This section canvasses four financing models. The Working Group is aware that there are other financing and operational models which would support affordable housing and that may have substantial merit. The description of these four models is therefore not intended to constrain the presentation of new proposals within the scope of this Issues Paper.

Barriers to large-scale investment

There are a number of issues that would need to be addressed in order to successfully establish and embed any of the models discussed in this paper. The Australian Housing and Urban Research Institute (AHURI) outlined these barriers in detail in their March 2013 paper 'Financing rental housing through institutional investment'.⁷

The Working Group is seeking feedback on the viability of these four models to attract institutional investment, and how the barriers listed below could be addressed to allow their implementation.

The key barriers to increased private institutional investment in affordable housing in Australia include:

- **scale** - institutional investors require scale to justify the due diligence costs associated with new investment classes, as well as their need for diversification to address issues with portfolio risk;
- **return** - investors require secure and predictable returns commensurate with similar investment classes and risk profiles;
- **liquidity** - while both retail 'mum and dad' investors and institutional investors are likely to hold investments for a number of years, regulation of many of these funds requires that only

⁷ AHURI March 2013, 'Financing rental housing through institutional investment'. Available at: www.ahuri.edu.au/publications/projects/p71016



a certain proportion of the total portfolio be invested in assets that are illiquid as institutional investors require the ability to disinvest quickly;

- **investor awareness** - investors are not currently aware of opportunities in affordable housing and largely see the sector as not worth the effort, as property exposure can be gained through other investment assets such as bank shares;
- **long-term consistent policy settings** - institutional investors require a stable, robust and durable government commitment in order to manage and assess risk and returns;
- **project pipelines** - it may be necessary for affordable housing investment to be pre-planned and long-term, to ensure it is worthwhile for the private sector to invest in expertise and capability in this asset class;
- **capacity** - while the community housing sector has expanded significantly, it still remains only one quarter the size of the public housing system; and
- **governance** - institutional investors may be keen to see independent governance structures and improved transparency and reporting, to ensure decisions are made in the interests of maximising the value of the property portfolio and the associated income streams.

Broad-based discussion questions

1. What are the key policy, funding, regulatory or legislative changes that government(s) should consider to implement new financing models for affordable housing in Australia?
2. How can governments ensure sustainable improvements in the housing outcomes of current affordable housing tenants within the current fiscal environment?
3. How can the cost base of new affordable housing assets be minimised? How can the return generated from affordable housing assets be maximised?
4. What would governments need to do to ensure that assets targeted to low income tenants, for example social housing, are not lost to higher income earners?
5. What role can the community housing sector play in implementation of new financing models to increase the supply of affordable housing?



Model 1: Housing loan/bond aggregators

The introduction of housing bonds has been proposed as a way of attracting greater private sector investment in affordable housing in Australia. Housing providers often find it difficult to attract finance to expand as the loans they are seeking are either too small for institutional investors, or are not viable for the housing provider.

Housing bonds provide a vehicle to aggregate debt financing and allow housing providers to combine their finance requirements to obtain funding from the wholesale market at a cheaper price than would be available to them individually. Reduced financing costs may give housing providers the capacity to expand and increase the supply of affordable housing. Bonds can also be traded on the market, making them more attractive to private investors.

The introduction of any housing bond would require the establishment of a specialist financing intermediary. The intermediary could be a government entity, a not-for profit, or a private sector entity. The intermediary would need to be subject to an appropriate regulatory framework.

Once established, the financing intermediary would liaise with social and affordable housing providers to determine the amount of debt they were seeking to raise. The intermediary would then directly source these funds in aggregate from wholesale markets by issuing housing bonds to private investors. The funds generated would then be loaned to the relevant social and affordable housing providers in return for ongoing interest payments and the return of the capital at the end of the life of the bond.

Example

The Housing Finance Corporation (THFC) established in 1987 is an independent, specialist, not-for-profit organisation that makes loans to regulated Housing Associations that provide affordable housing throughout the United Kingdom. THFC funds itself through the issue of bonds to private investors and by borrowing from banks.

Discussion questions

1. What policies, funding and regulatory settings would be required for a housing bond to be implemented in Australia?
2. What is the specific role(s) that government(s) may need to play, over time, to meet investor requirements around the establishment of a housing bond?



Model 2: Housing trusts

Housing trusts have been suggested as a means of overcoming the current difficulties with scale, and the geographical diversity of assets required to attract large-scale investors into the provision of affordable housing.

The establishment of an housing trust would allow for housing assets to be aggregated at an individual state or territory level, across several states and territories or even nationally by community, private sector or government providers of affordable housing.

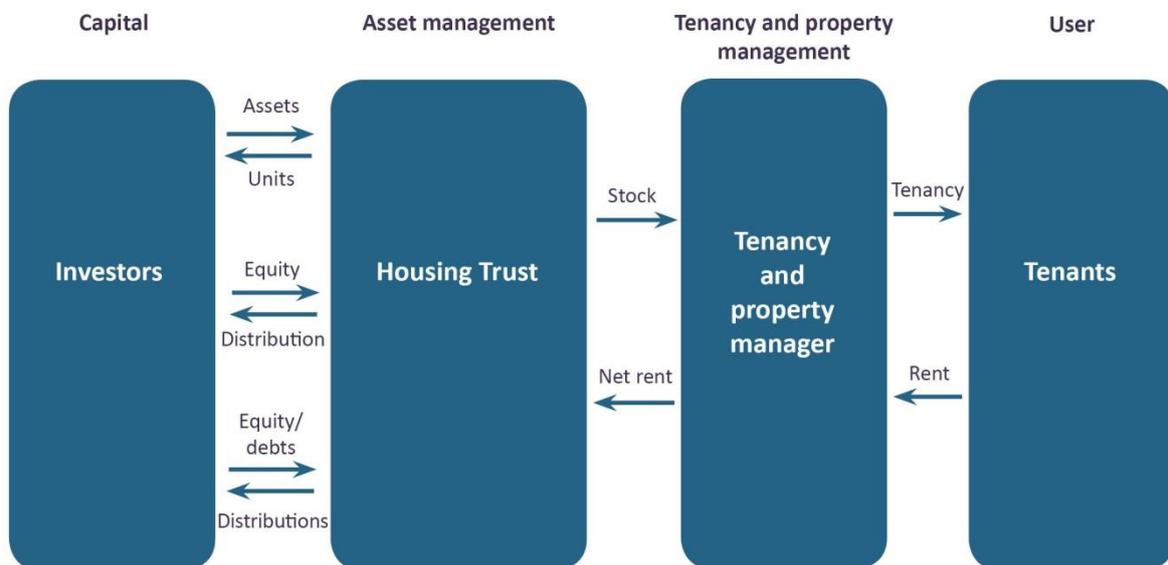
The trust structure also provides a vehicle for the aggregation of equity investment and would allow investors to either purchase units in the income stream from the trust, or the capital assets of the trust, or both, depending on their investment profile.

The trust could be held privately or listed, with a mixed public/private ownership, noting that the listing of the trust would provide the liquidity of investment commonly sought by institutional investors.

An housing trust structure could also allow the recycling of capital by governments, as well as a means to access additional capital through the gearing of the assets held by the trust. A housing trust also allows the flexibility of having the housing assets of the trust managed by government, the community sector or the private sector.

Once established, housing providers could potentially transfer stock into the trust in return for the units of equivalent value to the transferred housing stock (see Figure 2).

Figure 2: Elements of an affordable housing trust model



Example

The Housing Partnership Equity Trust (HPET) is a United States social-purpose Real Estate Investment Trust, sponsored by the Housing Partnership Network. The HPET provides a ready source of long-term, low-cost capital, enabling its non-profit partners to quickly and efficiently acquire apartment buildings that provide quality homes for families, seniors and others with modest incomes.



The HPET was established in 2013 with \$100 million raised from Citi, Morgan Stanley, Prudential Financial, Inc., the John D. and Catherine T. MacArthur Foundation and the Ford Foundation. HPET and its partners now operate properties in over 30 markets across the United States.

Discussion questions

1. What policies, funding and regulatory settings would be required to implement an housing trust in Australia?
2. To what extent could an housing trust model advance the objective of providing sustainable, large-scale finance for social and affordable rental housing for people on low incomes?
3. How might the composition of social and affordable housing stock and income streams impact on the trust? How would regional variations in asset values and rental streams (e.g. Hobart versus Sydney rents and house prices) affect distributions from the trust?
4. Are there any potential benefits for investors in affordable housing that could be achieved from splitting the income and capital returns of an housing trust?



Model 3: Housing cooperatives

Housing cooperatives are not-for-profit legal associations formed for the purpose of providing a housing product for members, and are usually owned and controlled by members. Many housing cooperatives are organised and managed on principles of participatory democracy and a common purpose. They seek to blend the provision of affordable housing with direct member participation and, depending on the model, shared equity.

There are several means by which financing can contribute to the establishment and operation of a housing cooperative. Full equity cooperatives exist whereby funding is derived directly from the members. The rent charged is very similar to the private market.

Shared equity cooperatives involve funding from a mix of public and private sources. The housing provided may have originated from external grants or loans, which may enable affordable housing to be offered.

The third option, more typical in the Australian context within the community housing sector, is the non-equity rental model. Social housing providers, such as public housing authorities, provide housing to the housing cooperative via various legal mechanisms. Tenants are usually charged social housing rents.⁸

Example

Common Equity Housing Limited (CEHL) in Victoria is the largest owner of housing amongst Victorian housing associations with around 2,200 properties under management. CEHL is a housing provider and developer of affordable housing, whereby properties are head-leased by 112 individual cooperatives across Victoria. Around 5,115 people are housed by CEHL in Victoria.

CEHL promotes a cooperative housing model for the individual cooperatives and provides asset management, finance and administration support to individual cooperatives. Individual cooperatives are shareholders of CEHL, and influence the direction of CEHL housing policy.⁹

Discussion questions

1. To what extent could a housing cooperative model advance the objective of providing sustainable large-scale finance for social and affordable rental housing in Australia?
2. What are the policy, funding and regulatory settings required to support any expansion of housing cooperatives?

⁸ Federation of Housing Collectives 2016, *Funding models*, www.fohcol.org.au/~fohcolor/node/11

⁹ CEHL 2015, *CEHL Annual Report 2015*, www.cehl.com.au/index.php?page=annual-report



Model 4: Impact investing models including social impact bonds

Impact investing has recently gained prominence as a tool for governments and service providers to creatively explore improving both social outcomes and the economic efficiency of the investment. Impact investing models allow investors to pursue opportunities that provide both social and financing returns through either direct investment in not-for-profit or social enterprises, or through alternative intermediaries and social impact bonds.

Social impact investment offers an opportunity to bring together capital and expertise from the public, private and not-for-profit sectors to deliver better outcomes for the community. It is an investment with the expectation of a social and financing return by attaching a value to defined outcomes and measuring both the outcomes and financing returns achieved. Key features for a viable social impact investment include robust measurement, value for money, a service likely to achieve social outcomes and appropriate sharing of risk and returns.

Social impact bonds involve the public sector issuing a contract with non-government providers, in which a commitment is made to pay for improved social outcomes that result in public sector savings.

Example

A homelessness social impact bond project was launched in London in November 2012. It was designed to improve outcomes for persistent rough sleepers, a sample population of 830. This social impact bond helps the cohort access appropriate services via personalised recovery pathways and into sustainable outcomes. Two participating organisations each target half of the cohort, both utilising a different financing structure.

The first organisation established a special purpose vehicle which holds the risk, while the second organisation funds interventions through social investors' unsecured loans, whereby the risk is shared across parties. Both participating organisations had invested their own funds.

There are five outcomes for the two organisations to achieve, which include reducing rough sleeping, stable accommodation, reconnection, employment and health. Each of the five outcomes is allocated a different proportion of the overall funding available, and evidence must be provided before payment can occur across the individual outcomes.¹⁰

Discussion questions

1. What areas of social or affordable housing could benefit from the introduction of impact investment models, including to augment or operate alongside other models in Australia?
2. What are the policy, funding and regulatory settings are required to support large scale social impact investment?
3. Could impact investment models assist in improving the social and economic wellbeing of social housing tenants and assist in the movement of households up the housing continuum?

¹⁰ Department for Communities and Local Government 2015, *Qualitative evaluation of the London homelessness social impact bond: Second interim report*, March 2015



Other issues to consider

The Working Group acknowledges that financing models need an appropriate policy, legislative and regulatory environment in order to function effectively, and optimise affordable housing outcomes. The Working Group therefore seeks additional information on other reforms which would help enable or reinforce affordable housing outcomes through new innovative financing models.

Submissions should canvass how existing Commonwealth and/or state and territory policies could be reformed to facilitate the implementation of new financing models for affordable housing, but as previously stated the purpose of this process is not to undertake a detailed examination of CRA, NRAS, taxation, land release, planning, zoning or the regulation of tenancy arrangements and community housing providers.

Focus of submissions

Submissions should:

- provide a detailed outline of the proposed model, what outcomes it would deliver, and how the proposed model overcomes barriers to investment, reinforced by supporting evidence;
- outline what roles would be played by investors, governments, the not-for-profit sector and others;
- consider the short-term versus long-term aspects of government support when designing the operational aspects of a proposal, including how the model may become independent of government over time;
- outline key operational design elements and implementation options of the model, including whether the proposal can be trialled, and if successful scaled up;
- outline how the model minimises capital costs and maximises income so as to reduce the need for ongoing government involvement and assistance, while continuing to provide low cost rental housing for those on low incomes;
- explain how any major barriers to implementation, such as those outlined previously, can be addressed including what funding, policy, legislative and regulatory support would be required;
- provide an estimate of the implementation costs; and
- take into account the constrained overall fiscal environment across the Commonwealth and states and territories.

